HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

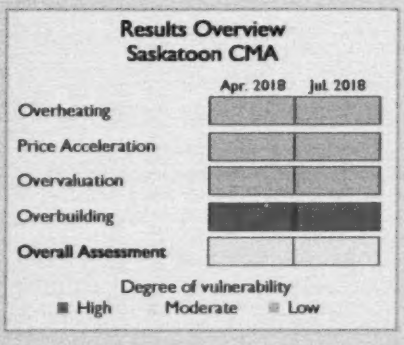
Saskatoon CMA

Date Released: Third Quarter 2018

Canada

CMHC SCHL

Highlights



- The Housing Market Assessment (HMA) framework continued to detect a moderate degree of vulnerability in the Saskatoon market.[1]
- There continued to be low evidence of overvaluation in house prices.
- Evidence of overheating and acceleration in the growth of house prices also remained low.
- High evidence of overbuilding in Saskatoon's market was maintained on discretionary grounds. However, there are continued signs that this imbalance is unwinding.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the HMA, CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects degrees of vulnerability in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the degrees of market vulnerability. The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average), and the persistence over time. Generally, low intensity and persistence are associated with a potentially low degree of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability increases.

In Detail

Low evidence of overheating

According to the Q1 2018 results of the HMA framework, there continued to be low evidence of overheating in Saskatoon's housing market. While the pace of existing home sales slowed in the quarter, new listings declined even more, resulting in a slight uptick in the seasonally adjusted sales-to-new-listings ratio (SNLR) to 41% from 40% in Q4 2017. However, the SNLR remained significantly below the framework's threshold for overheating of 85%.

Slow economic growth and tighter mortgage qualifying rules combined to temper resale demand in the first quarter of 2018, with total MLS® sales trending lower from Q4 2017. On the supply side, both active and

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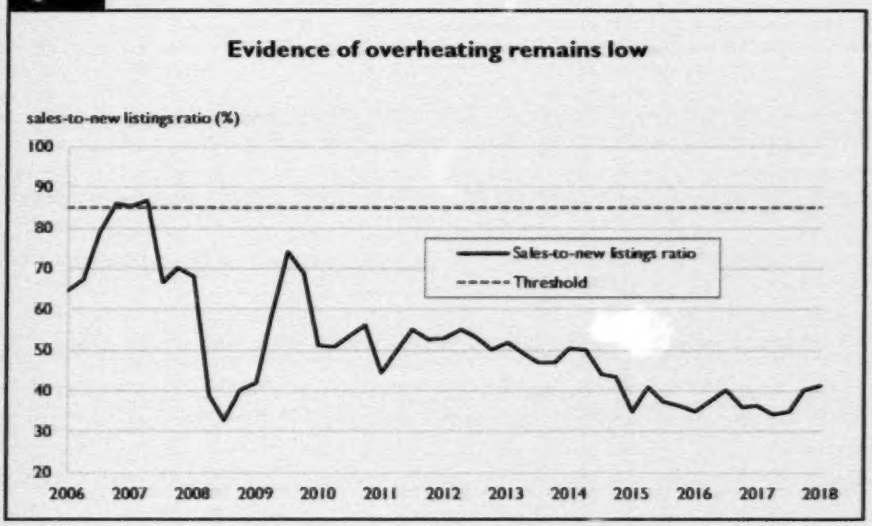
[1] Results are based on data as of the end of March 2018 and local market intelligence up to the end of June 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

Figure 1



Source: CREA (seasonally adjusted), calculations (threshold) by CMHC
Last data point: 2018Q1

new listings trended sharply lower from the preceding quarter. As a result, market balance for existing homes slightly improved in Q1 2018, compared with the fourth quarter of 2017.

Price acceleration remains low

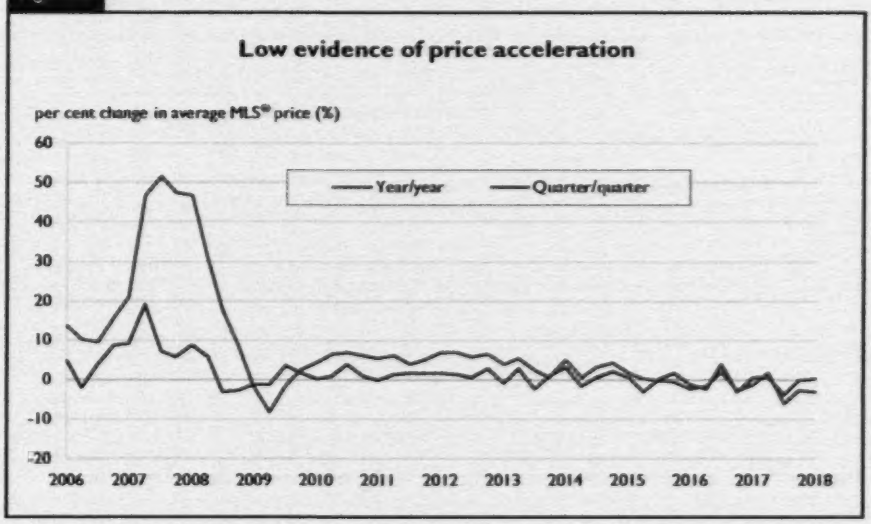
Evidence that the growth of house prices was accelerating remained low in Q1 2018. Despite the drop in listings, overall market conditions continued to favour buyers over sellers. While the seasonally adjusted average MLS® price edged up to $330,370 in Q1 2018 from $329,397 in Q4 2017, the MLS® HPI composite benchmark price declined to $293,100 from $297,700 in the fourth quarter of 2017. This price measure was also down 3.7% in Q1 2018 from the same quarter a year earlier, and was significantly lower than the five-year average of $312,600.

Among housing categories, the MLS® HPI benchmark prices for single-family, townhouse and apartment units all declined in Q1 2018 from Q4 2017, and were down on a year-over-year basis. Compared with the same quarter the previous year, the price decline during the first quarter of 2018 was significantly larger among townhouses where supply was far exceeding demand. Nonetheless, prices in all three categories were below their respective five-year averages.

Goodson Mwale
Senior Analyst, Economics (Saskatoon)

"Overall, the HMA framework detected a moderate degree of vulnerability in the Saskatoon housing market. Evidence of overheating, overvaluation and accelerating house prices remained low. However, new housing inventory has continued to decline, which could warrant an improvement to the assessment of overbuilding in the next few quarters."

Figure 2



Source: CREA (seasonally adjusted), CMHC calculations
Last data point: 2018Q1

[3] Source: CREA. The MLS® HPI is based on a hybrid model that merges repeat-sales and hedonic price approaches, and reflects the contribution made by various quantitative and qualitative housing features toward the home price.

Low evidence of overvaluation in house prices

The HMA framework detected low evidence of overvaluation as several house price measures continued to trend lower in Q1 2018, while growth in some underlying fundamentals such as the young adult population remained positive.

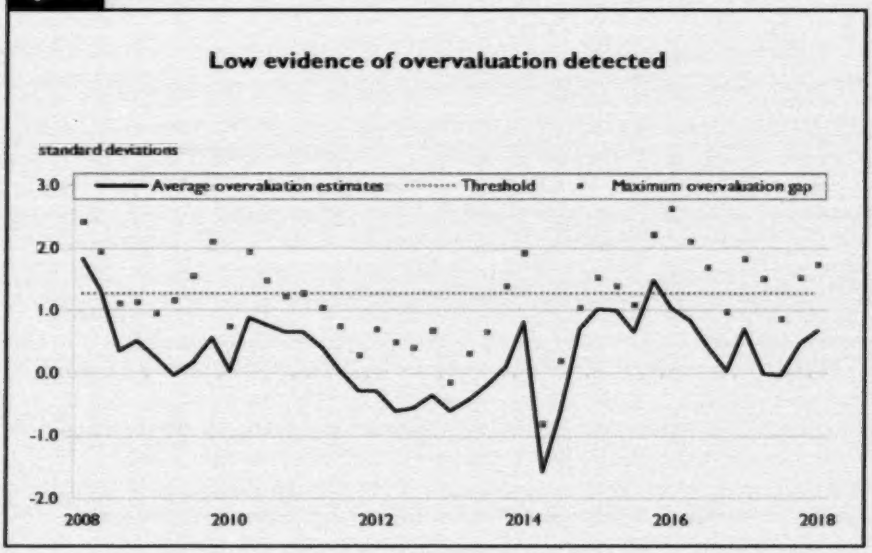
As shown in figure 3, the average estimate of overvaluation obtained from a group of selected models remained below the critical threshold. However, the maximum overvaluation gap from the hybrid model using the MLS® average price and the NHPI was above the threshold, which warrants close monitoring of these indicators moving forward.

New housing inventory is receding

According to the results of the HMA framework, Saskatoon's inventory of completed and unsold units per 10,000 population moved below the critical threshold in Q1 2018. This represents the first time in three years that this measure was below the threshold, which indicates that overbuilding in the Saskatoon market continues to unwind. However, a change in assessment from high to moderate evidence of overbuilding would require that the inventory indicator remained below the threshold for at least two more consecutive quarters.

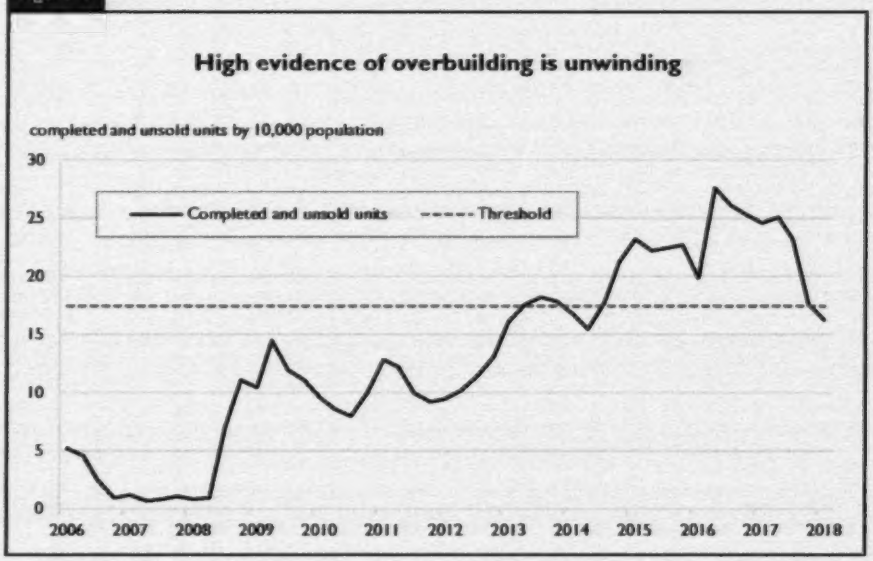
In addition, Saskatoon's rental apartment vacancy rate of 9.6% in October 2017 was above its critical threshold of 7.47%. Therefore, we have maintained the assessment of high evidence of overbuilding in Saskatoon's market in the current release.

Figure 3



Sources: CREA, Statistics Canada and calculations by CMHC. Last data point: 2018Q1
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. Baseline models include demand, supply, hybrid, and affordability models, each of which is estimated using four measures of house prices to generate sixteen unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Ordinary Least Squares (DOLS). The maximum overvaluation gap is obtained from the model that has the largest gap between the actual price and the estimated price. The threshold is fixed at a critical value of 1.29 for a confidence level of 80%. Overvaluation is signaled when overvaluation estimates lie above the threshold.

Figure 4



Source: CMHC, calculations (threshold) by CMHC
Last data point: 2018Q1

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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